Hershey Foods Corporation

Hershey Foods Corporation
and Subsidiaries

TO OUR STOCKHOLDERS:

Your Company completed its 70th year with record sales; however, because of an unusual combination of conditions discussed in this letter and elsewhere in this report, earnings were not satisfactory.

As shown in the financial highlights on the opposite page, consolidated sales of $442,709,875 showed an increase of 6.4% over 1972. Earnings declined primarily because of the spiraling cost of raw ingredients, packaging materials, supplies, labor, and services and the inability—partly because of government controls—to reflect such increases fully and promptly in prices of finished consumer goods.

The impact of the current high cost of cocoa beans as well as other items is expected to be greater in 1974 than it was in 1973. Despite this cost picture, the Company expects to maintain its market share in the industry and great effort is being made to cope with the cost problem. At the beginning of 1974, most of our 10-cent bars were eliminated and a line of 15-cent bars was introduced to replace them.

The last world crop of cocoa beans was 12% lower than the record crop harvested in 1971-72, and this disappointing outturn, together with the seemingly insatiable demand for commodities in general, sent the price of cocoa beans to unprecedented highs. This, of course, has caused consumption throughout the world to decline and, as the present crop is expected to be somewhat better than the preceding one, there is good reason to believe the price of this commodity will return to more reasonable levels.

Elsewhere in this report is a summary of the operations of our subsidiary companies. As can be seen from it, the pasta companies did exceptionally well and, although the operating results of Portion Control Industries showed improvement over the

Harold S. Mohler
President

William E. Schiller
Chairman of the Board

previous year, they were still not satisfactory. The government price ceiling on beef and the resulting shortage of that commodity created new and vexing problems for this subsidiary. With the lifting of price ceilings, operating results improved and we are confident about the future of this company. The operating results of Cory Corporation showed a decline from the previous year, but organizational and product changes are expected to improve performance.

In the chocolate and confectionery industry, historically there has been a lag of several months from the time commodity prices increased until they were reflected in the weights and the prices of our consumer products. This lag has been lengthened under the present system of price controls, and compliance regulations require constant changes in our marketing plans.

No severe adverse effect upon our operations is expected because of the national energy crisis. We do foresee increased costs of supplies and transportation and possible delays in receiving wrapping and packaging materials as a result of the crisis.

Because of the decline in earnings for the year 1973 and since it does not appear that increasing costs and price controls will permit a return to previous earnings levels in the immediate future, your Board of Directors decided to reduce the regular quarterly dividend to 20 cents a share effective with the payment on March 15, 1974. This was felt necessary in order to retain funds in the business for maintaining our market share in the industry. Every effort will, of course, be made to restore the Company to its former earnings position.

We owe a special debt of gratitude to our employees for their continuing efforts in helping us to reduce costs and improve the efficiency of our operations.

W. E. Schiller

Chairman of the Board

H. S. Mohler

President

February 28, 1974

Under the Corporation's policy of retirement at age 65, W. E. Schiller retired on March 1, 1974, after 26 years of service. The important role he played in the Corporation will be described in the 1974 Annual Report.

Hershey Foods Corporation
and Subsidiaries

FINANCIAL HIGHLIGHTS

	1973	1972
Per Common Share		
Net Earnings*	$1.10	$1.58
Dividends	$1.10	$1.10
Operations		
Net Sales	$442,709,875	$416,171,159
Earnings before Income Taxes	27,652,573	40,556,453
Income Taxes	13,347,000	19,914,800
Net Earnings*	14,305,573	20,641,653
Average Common and Common Equivalent Shares Outstanding	13,023,952	13,064,030

**During 1973, the Company reduced inventory quantities, primarily cocoa beans. This reduction resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the average unit cost of 1973 procurements, the effect of which increased net income by approximately $2,140,000 or $.16 per share.*

Hershey Foods Corporation
and Subsidiaries

Harold S. Mohler
President

William E. Schiller
Chairman of the Board

WE ARE PLEASED TO ANSWER QUESTIONS FREQUENTLY ASKED ABOUT OUR OPERATIONS.

Q.
If adequate supplies or high costs of cocoa beans continue to be a problem, do you see the possibility of using substitutes?

A.
Substitutes are now being used in the industry. Continuing high prices, of course, encourage their use. Our research people have been working in this area for some time with substantial progress to report. You may rest assured that if Hershey resorts to using substitutes, there will be no deterioration of quality.

Q.
Has the advertising program, after three years of existence, had a significant impact on sales?

A.
The record of the last three years shows that advertising has had a positive impact on sales. In 1973 advertising expenditures for all divisions were approximately $9.8 million compared with $14.4 million in 1972.

Q.
Have you received much public reaction to your decision to use nutritional labeling on the 15¢ Milk Chocolate bar?

A.
While the decision was made for the purpose of communicating the nutritive aspects of this Hershey product and not primarily to generate a response, reaction has thus far been favorable.

Q.
What is management doing to improve the operating results of National Portion Control?

A.
Considerable progress was made in the latter part of 1973 by the earlier restructuring of the NPC organization and by taking effective measures as soon as wage and price controls permitted.

Q.
Why doesn't the company grow its own cocoa beans and sugar?

A.
Many years ago, Mr. Hershey, through an affiliated company, did grow and refine sugar in Cuba. In 1946 the operation was sold because of the uncertain prospects for the business. Although we have had no experience in growing cocoa beans, we believe that it is better to buy them in the free market, just as we believe it better to buy sugar in the free market. The matter is being reviewed continually.

Q.
Will distribution of Rowntree Mackintosh items be expanded?

A.
Yes. In fact, several new products are currently being test marketed. It's also planned to test market some new Hershey and Reese products in the future as well.

Q.
How many price increases did you have in 1973 and when?

A.
There were several in the Chocolate and Confectionery Division—one the early part of the calendar year 1973 and another on October 15. There were also numerous price increases in the subsidiaries.

Q.
What are the major reasons for large sales increases in the macaroni subsidiaries?

A.
Because of the high price of meat, macaroni became a more important part of the diet. Demand throughout the industry has been at a very high level.

Q.
Is Hershey's Chocolate World living up to expectations? Has public response to it been favorable?

A.
In the latter six months of 1973 during which Hershey's Chocolate World was operating, over a million persons toured the facility. The response of visitors has been excellent.

ENERGY ENVIRONMENT

Through the winter of 1973-74 we experienced no fuel shortages at any of our manufacturing plants, most of which have dual fuel arrangements. Almost instantaneously these plants can switch from one fuel to another, such as oil or gas. Some modest capital expenditures have been authorized to reinforce this capability.

We do not expect any significant direct impact caused by fuel shortages. We expect substantial increases in electrical energy rates and the prices paid for fuel. While the increases are substantial for this segment of our costs, such costs are not a very large portion of total costs.

Environmental improvement has always concerned Hershey management. The increasing general environmental awareness together with more stringent governmental controls has caused us to intensify our efforts in the area of environmental protection. The Company, in order to meet its responsibilities, has for many years made investments for environmental considerations. Though important, the required expenditures have not been significant or material with respect to the Company's resources or operating expenses.

In addition to the efforts of the Company as such, several of our managers actively participate in community programs as part of Hershey's commitment to a better environment for all.

Louis C. Smith
Vice President, Technical

CHOCOLATE & CONFECTIONERY

1973 Sales—$351,000,000
1972 Sales—$335,000,000
1973 Net Income—$13,070,000
1972 Net Income—$19,600,000

The year 1973 was one of change and frustration in the Chocolate & Confectionery Division—change necessitated primarily by unprecedented increases in the cost of everything it takes to manufacture our products, and frustration because we were unable to make the necessary adjustments in prices and weights in a timely, orderly manner because of the severe limitations and restrictions placed upon our flexibility of movement by government price controls. The result was another record year for sales, but one that was most disappointing because of the severe decline experienced in net income.

As was reported to stockholders throughout the year, market prices of cocoa beans, sugar, milk, almonds, packaging materials and supplies, labor, and services all increased at a rapid rate to levels significantly above what had been anticipated, with cocoa beans and almonds far surpassing previous highs. In order to cope with this situation, prices and weights were adjusted as authorized by the Cost of Living Council, but despite the changes made we could not catch up with the ever increasing inflationary rise in prices of ingredients and the other costs of doing business.

While it was possible to retain our line of Hershey's/Reese's items intact despite the weight and price changes made early in the year, those changes necessitated at the end of 1973 forced the elimination of many items from our line. For instance, most of the 10¢ bars have now been replaced with 15¢ bars heavier in weight than the former 10¢ bars. All other items remaining in the line were adjusted in weight and/or price with the net result that every item has been altered in one way or another for 1974.

William E. Dearden
Group Vice President

Throughout 1973 cost cutting programs were instituted in all phases of our business in an effort to offset the erosion in profits, but despite major efforts on the part of our people in this regard we still fell short of our goal. All of this is significant evidence of how distorted and unreasonable things can become when there is an artificially imposed system to keep consumer prices down despite the fact that the costs to make the products involved are rising at an ever increasing rate.

THE INDUSTRY

The entire chocolate and confectionery industry was faced with the same problems we faced in 1973. Thus, it has been forecasted that dollar sales will increase slightly to approximately $2 billion at wholesale prices for the year. It is estimated that the number of pounds of product sold will be lower than in 1972, with the result that per capita consumption will again decline for the year. This figure has steadily declined from a high of 20.3 pounds per person in 1968 to 18.8 pounds per person in 1972, the last published figure by the U.S. Department of Commerce; and it reflects the impact of the discontinuance of most 5¢ bars during this period as well as lower weights in the 10¢ bars as a result of inflation.

The chocolate and confectionery industry is a great industry which provides enjoyment and brings happiness to countless thousands of people every day at a very nominal cost — people of all age groups and in all walks of life. Hershey's and Reese's products occupy an important position in this great industry and have a strong franchise with our customers and the consumer.

Thus, we are very optimistic about the future and feel that if spiraling inflation can be checked and we can again have the freedom to operate our businesses as we know they should be operated, through the elimination of government price controls, then we will be able to achieve the growth in sales and profits so necessary for the development of the industry and our individual companies.

We are convinced people eat candy because they enjoy it. They enjoy it for many reasons—it tastes good; it is a great snack convenient to eat between meals; it gives them a lift. That is important to the future of our company and the industry.

NEW PRODUCTS

The test market results on After Eight—a delicious chocolate covered thin mint, and Rolo — a chewy toffee covered with chocolate, have been encouraging and will be continued in 1974. These Rowntree Mackintosh brands, along with several others, will be fully evaluated in 1974 to determine their potential in the U.S. market.

HERSHEY CHOCOLATE OF CANADA

Sales of the Canadian Organization continued to show good growth in 1973. However, because of an eleven-week strike and the same increases in costs as experienced by the U.S. organization, operations are not yet on a profitable basis.

In February 1973 the Confectionery Association of Canada was successful in its request to the federal government to have the 12% sales tax on confectionery removed. But this move has been more than offset by sharp increases in all costs — especially cocoa beans, sugar and milk, and the additional weight put into the bars as a condition for the removal of the tax.

In January 1974 the price of 10¢ bars was increased so that they now retail at 12¢, and it is expected that the industry will move to the 15¢ price by the end of the first quarter.

We continue to be optimistic regarding the success of our brands in the Canadian market, and are planning for increased sales and a modest profit in 1974.

L. D. PROPERTIES CORPORATION

This subsidiary company grows almonds on approximately 5,000 acres in California, and was profitable in 1973 as a result of an excellent crop which was sold at record prices.

While our ranches are not yet at full bearing, the progress made to date in this venture has proven it to be a sound investment.

OUTLOOK

As we look to 1974, undoubtedly we can anticipate continuing inflation, business problems in one form or another, and strong competition. The full energies of our managers have been directed toward ways and means of significantly improving productivity as well as eliminating wasteful practices wherever they exist in an effort to reduce operating costs in every department.

From the sales and marketing point of view, our efforts will be directed toward establishing the new 15¢ bars plus other new pack types and prices in the marketplace with our customers and the consumer. To date we have had excellent support from our customers in this transition, but, because of the selling through of former items, many of the new pack types and prices are just now reaching the retail counter for the consumers' decision. We are optimistic that we will gain their full support as well, since our high quality items, despite higher prices, still represent excellent value — the cornerstone on which our outstanding consumer franchise was built and has flourished.

RAW MATERIALS

Principal among the raw materials used by this division is, of course, cocoa beans. These beans are harvested from cocoa trees, which flourish only in the tropics. Ghana, in Africa, is the largest supplier of Hershey's beans, followed by Nigeria and Brazil. Other important sources include the Ivory Coast, Cameroon, Dominican Republic, Ecuador, Venezuela, Mexico, Trinidad, Costa Rica, Jamaica, and Haiti plus New Guinea, Samoa and Java in the Pacific. Hershey purchases cocoa beans directly from producers in Africa, from dealers in the United States, and in the form of futures contracts on the New York and London Cocoa Exchanges.

Over the past two decades, the price of cocoa beans has been extremely volatile. While both production and consumption have grown significantly over the period, the respective increases have not been concomitant; thus fluctuations in prices have been common. In 1973, when production declined because of poor weather conditions and consumption continued to expand, the price increase was rather dramatic. The situation was further compounded by devaluation of certain currencies and by the operation of speculators in the cocoa bean market.

An international cocoa agreement, signed on July 1 by all major producers and consumer nations except the United States, has had little impact to date because the prices of cocoa beans have been considerably above the agreement's ceiling price of 32¢ per pound in New York Futures and because there have been no surplus stocks on hand to offer the market in an effort to temper the price.

Hershey's second most heavily used raw material is sugar. In the East, most of the sugar is purchased from cane refineries in Philadelphia. The Oakdale plant on the West Coast uses mostly beet sugar grown in California. Sugar prices are regulated by the U.S. Department of Agriculture and are based on the wholesale price index and farm parity price both of which rose significantly in 1973; thus the market price of sugar was 13% higher in 1973 than in 1972.

Milk is purchased daily from more than 1,300 farms in the vicinity of our plants. Yearly intake is nearly 400 million pounds. The major portion of this milk is picked up with bulk tank units from the farms. Like sugar, the price of milk is supported by the United States Government, and market prices rose 21% during 1973.

Other commodities used in great volume are almonds and peanuts. Hershey obtains all of its almonds from California, the major portion from ranches of our own L. D. Properties Corporation. Almond prices nearly doubled in the past year. Peanuts come primarily from Georgia, Alabama, Texas and Oklahoma, and prices of this commodity rose by 14% in 1973.

Julian Hemphill
Director of
Cocoa Bean Purchases

Richard L. Uhrich
Vice President and Secretary

CORY CORPORATION

Cory Corporation, including its subsidiary companies in Canada, performed only adequately in the year 1973. Although sales hit a new high of $44 million compared with $41 million in 1972, profits after taxes fell to approximately $910,000 from $1,250,000 in the preceding year. One of the more serious problems was an inability to achieve sufficient gross profit margins in the consumer products area. Market share in some of Cory's seasonal products could not be increased significantly and resultant production and sales efficiencies could not be enjoyed. Therefore, the decision was taken to sell the seasonal products portion of the business as well as the name Fresh 'nd-aire. The sale has been made to two companies currently in consumer seasonal products manufacturing. This transaction did not result in any significant gain or loss.

The strong position Cory enjoys in the restaurant/institutional business will continue to be further exploited in 1974. The new products earmarked for production in this year have been substantially field tested and market tested. We believe they will make a significant contribution to sales and earnings in the forthcoming year.

Coffee Service sales constituting nearly 75% of the total sales of Cory continued to expand during 1973. Increasing costs, including raw material costs, made it difficult to achieve profit projections, but profits were satisfactory. Market penetration increased, new branches were opened, and a new field management structure inaugurated. Companion products to coffee are in field test constantly. This area of Cory continues to have an especially bright future.

PORTION CONTROL INDUSTRIES, INC.

The year 1973 proved to be a most trying one for National Portion Control, the major operating arm of Portion Control Industries. Sales of about $27 million were enjoyed, but a net loss of $370,000 ($950,000 before tax and investment credit) was the disappointing result. For the preceding year sales were $24 million and there was a net loss of $680,000 ($1,444,000 before tax).

Richard A. Zimmerman
Group Vice President

National Portion Control, like many of its competitors, found the government's ceiling prices and the resultant shortage of beef to be quite confounding. Between the dates of March 29 and September 10 — the period in which selling prices were frozen —National Portion Control failed to record a profitable month. Gross margins shrank to unsatisfactory points, many items were dropped completely from the line because they were profitless, and many raw materials were unavailable at the ceiling prices established for them.

There was an improvement in operating results in the fourth quarter. We are still faced with high raw material and other costs but are optimistic about being able to cope with them.

The recent additions to physical plant are in full use. Our plants are new, highly automated and quite flexible. The new processing lines permit us to serve a variety of customers from airlines to white linen tablecloth restaurants to school lunch programs with high quality, wholesome products. The line of pre-cooked frozen products ranges from beef patties to beef rouladen — from chicken tetrazzini to turkey-noodle casserole—from cold sandwiches to a complete school lunch Type A meal.

We are confident of the future. Fourth quarter 1973 results indicate that National Portion Control can be a profitable operation while continuing to exercise its leadership position in the Food Service Industry.

SAN GIORGIO MACARONI, INC. AND DELMONICO FOODS, INC.

Our pasta companies, San Giorgio and Delmonico, established rather remarkable records in the year 1973. Combined sales increased by over $5 million to approximately $21 million and net earnings after tax totaled nearly $700,000, compared with $480,000 in 1972.

The record dollar sales were partially due to semolina flour costs and resultant higher prices for our products. The majority of the sales improvement, however, is attributable to unprecedented demand for the companies' products, especially in the branded items available through regular retail channels.

The generally higher meat prices appear to be having a salutary effect upon our pasta businesses. Demand during the year outstripped our supply capability. Among the major achievements in 1973 were the completion of an 80,000 square foot building addition by San Giorgio and the undertaking of substantial capacity enlargement at Delmonico Foods in Louisville.

San Giorgio also completed a transaction in which it acquired the assets of a small frozen food processor in eastern Pennsylvania. Five new frozen entrees are now on the market under the San Giorgio label in areas in which the company's brands enjoy a position as the leader in market share.

The Cost of Living Council regulations have permitted the companies to generally pass through costs incurred during the year. This cost pass-through permits the maintenance of gross margin dollars but not of gross margin percentages. Demand for the companies' products will have to remain at high levels at the current gross margin percentages for us to continue to experience improvements in earnings. The capacity expansion program in each of the companies indicates that we believe the demand for our branded merchandise will continue to grow at quite satisfactory rates.

Hershey Foods Corporation
and Subsidiaries

CONSOLIDATED STATEMENT OF INCOME AND RETAINED EARNINGS

	For the Years Ended December 31 1973	1972
NET SALES	$442,709,875	$416,171,159
COSTS AND EXPENSES:		
Cost of goods sold (including $4,500,000 reduction resulting from LIFO inventory liquidation in 1973—Note 1)	314,497,334	273,899,138
Selling, administrative and general	62,099,138	67,832,009
Shipping	25,322,183	24,143,263
Depreciation	7,506,370	6,129,746
Interest	5,632,277	3,610,550
Total costs and expenses	415,057,302	375,614,706
Income before income taxes	27,652,573	40,556,453
PROVISION FOR FEDERAL AND STATE INCOME TAXES (less allowable investment credits of $1,098,815 and $996,000) (Note 3)	13,347,000	19,914,800
NET INCOME	14,305,573	20,641,653
RETAINED EARNINGS AT JANUARY 1	169,494,934	162,147,149
	183,800,507	182,788,802
DEDUCT—Dividends: Preferred $.60 a share	240,000	240,000
Common $1.10 a share	13,006,502	13,053,868
RETAINED EARNINGS AT DECEMBER 31	$170,554,005	$169,494,934
NET INCOME PER COMMON SHARE (Note 6)	$1.10	$1.58

The accompanying notes are an integral part of this statement.

Hershey Foods Corporation
and Subsidiaries

CONSOLIDATED BALANCE SHEET

	December 31 1973	1972
ASSETS		
CURRENT ASSETS:		
Cash	$ 7,326,279	$ 8,152,743
Accounts receivable (less allowances for discounts and bad debts of $842,262 and $772,886)	27,325,712	26,292,777
Inventories: (Note 1)		
Raw materials	29,944,118	37,521,017
Goods in process	4,922,231	4,380,654
Finished goods	27,587,701	32,319,768
	62,454,050	74,221,439
Total current assets	97,106,041	108,666,959
PLANT AND PROPERTY, at cost:		
Land	4,824,912	5,139,778
Buildings	64,133,714	59,845,691
Equipment	124,191,654	112,252,310
	193,150,280	177,237,779
Less—accumulated depreciation	69,442,158	63,205,421
	123,708,122	114,032,358
GOODWILL	17,561,503	17,561,503
OTHER ASSETS:		
Deferred almond ranch development expenses	5,865,575	6,210,609
Deferred coffee service location costs	3,267,729	3,411,411
Other	4,649,542	5,844,146
	13,782,846	15,466,166
	$252,158,512	$255,726,986
LIABILITIES AND STOCKHOLDERS' EQUITY		
CURRENT LIABILITIES:		
Loans payable within one year (Note 2)	$ 854,463	$ 7,003,358
Accounts payable	12,877,055	11,094,437
Accrued liabilities	8,127,467	8,739,366
Federal and state income taxes payable	1,597,388	2,951,554
Total current liabilities	23,456,373	29,788,715
LONG TERM DEBT (Note 2)	51,470,402	51,364,444
DEFERRED INCOME TAXES	16,454,653	14,860,135
STOCKHOLDERS' EQUITY (Notes 4 and 5)		
Cumulative Preferred Stock— Authorized 2,000,000 shares; issued 400,000 convertible shares with dividend rate of $.60 per year	1,200,000	1,200,000
Common stock, without par value— Authorized 20,000,000 shares; issued 12,528,710 shares	9,391,496	9,391,496
Retained earnings	170,554,005	169,494,934
	181,145,501	180,086,430
Less—Treasury stock, at cost— 704,714 and 704,905 common shares	20,368,417	20,372,738
Total stockholders' equity	160,777,084	159,713,692
	$252,158,512	$255,726,986

The accompanying notes are an integral part of this statement.

Hershey Foods Corporation
and Subsidiaries

CONSOLIDATED STATEMENT OF CHANGES IN FINANCIAL POSITION

	For the Years Ended December 31	
	1973	**1972**
SOURCE		
Net income	$ 14,305,573	$ 20,641,653
Add—Expenses not requiring outlay of working capital:		
Depreciation	7,506,370	6,129,746
Deferred income taxes	1,594,518	2,240,635
Working capital provided from operations	23,406,461	29,012,034
Long term borrowings and proceeds from issuance of 7¼ % Sinking Fund Debentures in 1972	18,925,418	30,014,475
Effect on working capital resulting from sale of David & Frere (1967) Ltee	—	5,745,462
Proceeds from sale of land	—	3,143,840
Other (Net)	2,069,602	398,291
	44,401,481	68,314,102
DISPOSITION		
Dividends paid	13,246,502	13,293,868
Additions to plant and property	17,564,095	25,137,433
Payments of long term debt	18,819,460	5,568,952
Treasury stock acquired	—	3,914,030
	49,630,057	47,914,283
Increase (Decrease) in working capital	$ (5,228,576)	$ 20,399,819
CHANGES IN WORKING CAPITAL		
Increase (Decrease) in Current Assets:		
Cash	$ (826,464)	$ 3,689,508
Accounts receivable	1,032,935	(48,720)
Inventories	(11,767,389)	2,061,378
Total	(11,560,918)	5,702,166
Increase (Decrease) in Current Liabilities:		
Loans payable	(6,148,895)	(13,264,207)
Accounts payable	1,782,618	(1,429,257)
Accrued liabilities	(611,899)	1,668,640
Taxes payable	(1,354,166)	(1,672,829)
Total	(6,332,342)	(14,697,653)
Increase (Decrease) in working capital	$ (5,228,576)	$ 20,399,819

The accompanying notes are an integral part of this statement.

Hershey Foods Corporation
and Subsidiaries

NOTES

1.

SUMMARY OF SIGNIFICANT ACCOUNTING POLICIES

The following is a summary of the significant accounting policies followed by the Company:

PRINCIPLES OF CONSOLIDATION—The accompanying consolidated financial statements include the accounts of the Company and all of its subsidiaries. Intercompany balance sheet, income and expense accounts have been eliminated in consolidation. The accounts and transactions of the Company's Canadian subsidiaries and division are included in the accompanying financial statements at approximate current exchange rates, except that plant and property and the related depreciation expense are included at approximate exchange rates at dates of acquisition. Charges and credits to income as a result of foreign currency translation are insignificant in amount.

INVENTORIES—A substantial portion of the Company's major raw materials, together with such materials and certain wage costs included in finished goods and goods in process are stated at cost, under the LIFO (last-in, first-out) method. Such LIFO inventories amounted to approximately 38% in 1973 and 50% in 1972 of total inventories. The remaining inventories are stated at lower of cost or market under the "first-in, first-out" or "average cost" method. The excess replacement or market value over LIFO cost was $39,100,000 at December 31, 1973 and $19,100,000 at December 31, 1972.

During 1973, the Company reduced inventory quantities, primarily cocoa beans. This reduction resulted in a liquidation of LIFO inventory quantities carried at lower costs prevailing in prior years as compared with the average unit cost of 1973 procurements, the effect of which reduced cost of sales by $4,500,000 and increased net income by approximately $2,140,000 or $.16 per share.

DEPRECIATION—The Company and its subsidiaries follow the policy of providing for depreciation of buildings and improvements over estimated lives ranging from 20 to 50 years and of machinery and equipment over estimated lives ranging from 3 to 25 years. The companies have employed straight-line and various accelerated methods in determining the annual charge for depreciation.

GOODWILL—Represents the excess of cost over net assets of companies acquired at dates of acquisition. No amortization has been taken since, in the opinion of management, there has been no diminution of values of such assets.

DEFERRED ITEMS—Deferred development expenses consist of soil and water conservation payments and other preoperating expenses relating to the development of almond ranches by L. D. Properties Corporation, a wholly-owned subsidiary of the Company. Commencing in 1973, the first year of a substantial commercial harvest, the deferred expenses are being amortized over 18 years, which is the estimated commercially productive life of the almond trees.

Deferred location costs consist of certain expenses associated with the development and installation of new coffee service locations of Cory Corporation, a wholly-owned subsidiary. These costs are being amortized over the life of the installation, but not to exceed four years.

MARKETING COSTS—The costs of advertising and other marketing promotional programs are charged to expense during the year generally in relation to sales and, except for materials in inventory and prepayments, are fully expensed by the end of the year in which the cost is incurred.

INCOME TAXES—Federal and state income taxes are provided for based on income recorded in the financial statements. Deferred income taxes arise principally from the use of different methods of depreciation for tax and accounting purposes. The reduction in income taxes currently payable, resulting therefrom, is credited to deferred income taxes in the balance sheet. The provision for income taxes has been reduced by allowable investment credits.

RETIREMENT PLAN—The Company and certain of its subsidiaries have a Retirement Plan covering substantially all employees of such companies. The total pension expense in 1973 was $2,983,000 and $2,195,000 in 1972. The increase in 1973 pension expense is primarily attributable to increased benefits effective January 1, 1973. The Company's policy is to fund current service costs as incurred; virtually all past service liability has been funded.

2.

CURRENT AND LONG TERM DEBT

Loans payable within one year at December 31, 1973 include notes payable of $425,000 at interest rates of 9% and 10%, and current portion of long term debt of $429,463.

As a result of seasonal working capital requirements the Company established lines of credit from domestic banks of $35,750,000 with interest based on prime rates. The Company also obtained credit of $45,000,000 under a revolving credit and term loan agreement described below. The Company had short term borrowings oustanding under the lines of credit during the year which averaged approximately $6,400,000 and reached a maximum of $19,000,000. The weighted average interest rate on these borrowings was 8%. Additionally, the Company had borrowings under its revolving credit and term loan agreement during the year which averaged approximately $37,000,000 and reached a maximum of $45,000,000. The weighted average interest rate on these borrowings was approximately 8½%. While there are no formal compensating balance agreements under these credit arrangements, the Company has been expected to maintain

reasonable average compensating balances, as determined from bank ledger records adjusted for float. The Company has generally maintained average compensating balances fluctuating between 15% and 20% of borrowings.

Long term debt at December 31, 1973 consists of the following:

7¼% Sinking Fund Debentures due November 1, 1997. Payments to the Sinking Fund are required beginning November 1, 1978 in annual installments of $1,500,000	$30,000,000
Loan under revolving credit and term loan agreement, at prime interest rate (10% at December 31, 1973) until April 2, 1974 and ¼ of 1% above prime rate until April 2, 1976 and ½ of 1% above prime thereafter, payable in equal quarterly installments commencing July 2, 1976 and ending April 2, 1983.	18,500,000
Various other loans.	2,970,402
	$51,470,402

The revolving credit and term loan agreement is with two domestic banks and allows the Company to borrow up to $45,000,000. The outstanding balance at April 2, 1976 may be converted into a term loan with payment due as indicated above. As part of the agreement, the Company must pay a commitment fee equal to ½ of 1% of the unused portion of the commitment. In addition, the agreement contains certain restrictive covenants. The most significant of such convenants requires the Company as of each year end to maintain an excess of current assets over current liabilities of not less than $45,000,000, not to permit funded debt (debt which is due in excess of one year) to exceed 66⅔% of net worth and not to permit the ratio of current assets to current liabilities to fall below 1.5 to 1.

3.

INCOME TAXES—Federal and state income taxes are provided for based on income recorded in the financial statements. The provision for income taxes exceeds income taxes currently payable by $1,594,518 in 1973 and $2,240,635 in 1972. The sources of these differences and the related deferred tax effect were as follows:

	1973	1972
Excess of tax over book depreciation as the result of using accelerated depreciation methods for tax purposes	$1,924,486	$1,631,134
Changes in deferred expenses which (increase) decrease current taxes payable	(34,210)	617,800
Other timing items	(295,758)	(8,299)
	$1,594,518	$2,240,635

The following is a reconciliation of the provision for income taxes included in consolidated income and the amount computed by applying the Federal statutory rate to income before income taxes.

	1973		1972	
	Amount	%	Amount	%
Taxes computed at statutory rate	$13,273,235	48.0	$19,467,097	48.0
Increases (reductions) resulting from:				
State income taxes, net of Federal income tax benefit	1,342,640	4.9	1,781,104	4.4
Investment tax credit...	(1,098,815)	(4.0)	(996,000)	(2.5)
Other, net	(170,060)	(.6)	(337,401)	(.8)
Provision for income taxes	$13,347,000	48.3	$19,914,800	49.1

4.

Under the terms of the 1968 Stock Option Plan, a maximum of 500,000 shares of common stock may be issued to officers and key employees at not less than market value at the date such options are granted. The options are exercisable at any time until expiration, five years after granting or earlier in the event of death or other termination of employment by the optionee. During 1973, no options were granted or exercised and all outstanding options under the plan expired during the year.

5.

The preferred stock is convertible into the common stock of the Company on the basis of three shares of common for one share of preferred, in series, at various dates. All such Cumulative Preferred Stock must be converted by December 31, 1975. In the event of liquidation, each preferred share outstanding is entitled to the same amount as would be payable to the holder of three shares of common stock.

6.

Net income per common share has been computed based on the average shares of common stock and common stock equivalents outstanding during the period (13,023,952 in 1973 and 13,064,030 in 1972). The shares of $.60 Cumulative Preferred Stock outstanding during each period have been included in the computation at their common equivalent of three shares of common for one share of preferred.

Hershey Foods Corporation
and Subsidiaries

AUDITORS' REPORT

TO THE STOCKHOLDERS AND BOARD OF
DIRECTORS OF HERSHEY FOODS CORPORATION

We have examined the consolidated balance sheets of HERSHEY FOODS CORPORATION (a Delaware corporation) and subsidiaries as of December 31, 1973 and December 31, 1972, and the related statements of consolidated income and retained earnings and changes in financial position for the years then ended. Our examination was made in accordance with generally accepted auditing standards, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying consolidated financial statements referred to above present fairly the financial position of HERSHEY FOODS CORPORATION and subsidiaries as of December 31, 1973 and December 31, 1972, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied during the periods.

ARTHUR ANDERSEN & CO.

New York, N.Y.,
February 18, 1974.

Hershey Foods Corporation
and Subsidiaries

TEN YEAR SUMMARY SALES, INCOME AND DIVIDENDS

Year	Net Sales	Net Income Total	Net Income Per Common Share	Dividends Common	Dividends Preferred
1973	$442,709,875	$14,305,573	$1.10	$1.10	$.60
1972	416,171,159	20,641,653	1.58	1.10	.60
1971	401,879,817	20,493,201	1.55	1.10	.60
1970	349,636,499	18,857,596	1.41	1.10	.45
1969	333,973,154	13,574,611	1.01	1.10	—
1968	296,045,285	19,898,149	1.67	1.10	—
1967	246,745,196	20,934,705	1.75	1.10	—
1966	225,738,443	24,973,012	2.09	1.075	—
1965	211,780,687	24,722,000	2.02	1.00	—
1964	207,129,308	22,745,755	1.86	.925	—

Note:
Net sales, net income and net income per common share for 1969 have been restated to give retroactive effect to the pooling of Portion Control Industries, Inc. The years prior to 1969 have not been restated.

Hershey Foods Corporation
and Subsidiaries

ANNUAL MEETING

The Annual Meeting will be held at 2 p.m. on Monday, April 8, 1974, at the Hershey Motor Lodge and Convention Center, Route 322 and University Drive, in Hershey.

A formal notice of this meeting, together with a proxy statement, will be mailed to stockholders on or about March 15, 1974.

Stockholders who are unable to attend the meeting are urged to sign and return their proxies promptly so the stock of the company will be represented as fully as possible at the meeting.

Arthur R. Whiteman
Chairman of the Board
Hershey Trust Company
Chairman of the Board,
Hershey Estates

James E. Bobb
Chairman of the Board,
Milton Hershey School
President,
Hershey Estates

Samuel A. Schreckengaust, Jr.
Executive Partner,
McNees, Wallace & Nurick

BOARD OF DIRECTORS

W. E. Schiller
Chairman
J. E. Bobb
W. E. Dearden
J. Hemphill
H. S. Mohler
S. A. Schreckengaust, Jr.
L. C. Smith
R. L. Uhrich
A. R. Whiteman
R. A. Zimmerman

OFFICERS

H. S. Mohler
President
W. E. Schiller
Chairman of the Board
W. E. Dearden
Group Vice President
R. L. Uhrich
Vice President and Secretary
R. A. Zimmerman
Group Vice President
L. C. Smith
Vice President, Technical
L. W. Simmons
Treasurer and Comptroller

EXECUTIVE OFFICES

19 East Chocolate Avenue
Hershey, Pa.

TRANSFER AGENT

First National City Bank
New York

REGISTRAR

Morgan Guaranty Trust Company, New York

AUDITORS

Arthur Andersen & Co.
New York

Hershey Foods Corporation
and Subsidiaries

HERSHEY'S VISITOR PROGRAM

Though Hershey's plant tour helped win many friends for the Corporation over the years —

some 10,500,000 visited between 1928 and mid-1973—the new visitor facility, Hershey's Chocolate World, is helping the Company to tell part of its story to even larger numbers of people. Opened to the public on June 30, 1973, Hershey's Chocolate World played host to its 1,000,000th visitor on December 3, 1973, its 156th day of operation.

The new facility features an automated ride through simulations of plantations, scenes of cocoa harvesting and shipping,

and all the basic steps of chocolate making. Hershey's Chocolate World also presents some of the nostalgia of the Milton Hershey story, and it houses a tropical garden filled with authentic cocoa trees and numerous other plantings.

A number of shareholders have already visited Hershey's Chocolate World, and it is hoped that many more will visit in 1974. The facility is open from 8 a.m. to 5 p.m. Mondays through Saturdays, except Thanksgiving, Christmas, and New Year's Day. From early spring through late fall, it is also open on Sundays from noon to 5 p.m.

Tours are also offered at the Oakdale, California, plant, where 88,074 people visited in 1973, and at the Smiths Falls, Ontario, plant, which had 22,488 visitors in 1973.

Hershey Foods Corporation
Hershey, Pa. 17033, U.S.A.

HERSHEY
PENNSYLVANIA

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